



COUNCILMEMBER DONNA FRYE

City of San Diego
Sixth District

MEMORANDUM

DATE: October 16, 2006

TO: Mayor Jerry Sanders

FROM: Councilmember Donna Frye *Donna Frye*

SUBJECT: 2003 Comprehensive Annual Financial Report

On October 2, 2006, I received a copy of the City of San Diego's Fiscal Year 2003 Draft Comprehensive Annual Financial Report (CAFR). The draft CAFR contains a cover memo from the Mayor, stating "that this draft is substantially complete and contains all significant disclosure items," however, he can provide "no assurance that additional changes, some of which may be material in nature, will not be required as part of the Audit process."

Following are my preliminary written comments and questions based on my two-week review of the draft CAFR. I will provide more comments and questions once I have copies of the draft documents.

1. The CAFR should include a page identifying all the individuals who were responsible for its preparation.
2. Please provide to me any draft copies of the 2003 CAFR.
3. Has the city complied with all federal, state and local legal requirements regarding grant funds and loans? Are there any facts that have not been disclosed that could change or affect the information provided in the CAFR?
4. How much is the debt owed to the city by CCDC and SEDC in 2003 and where is that shown?
5. Do the city's 2003 long-term liabilities include pension obligations and where is that shown in the CAFR? Does it include health care liabilities? Is the capitalized liability shown for retiree health care?

6. What is the city and SDCERS liability for the Deferred Retirement Option Plan (DROP)? Where is that discussed?
7. What is the total cost of the city's 2003 deferred maintenance and where is that shown? What were the city's 2002 deferred maintenance costs, and how does this compare to 2003?
8. What are the total 2003 unfunded needs and where is that shown? How do the 2003 numbers compare to the 2002 numbers?
9. What is the total 2003 debt service on the city's bonds and where is that shown? Has the debt service increased since 2002?
10. Where are the long-term forecasts of the pension deficit or its corresponding required annual pension contributions shown?
11. Does the city's 2003 CAFR rely upon the numbers and representations made in the City of San Diego's 2002 CAFR? If so, are the 2002 numbers accurate and not misleading?
12. Does the city's 2003 CAFR rely upon the numbers and statements made in the 2003 SDCERS CAFR (or any other numbers from a component entity of the city, i.e. CCDC, SEDC, SDDPC) that was audited by the firm the City of San Diego sued for their 2003 audit work? Have all the component entities been audited by the city's CFO and Auditor for the 2003 CAFR? If not, why not? If so, were any changes made regarding assets and liabilities that affect the city's financial condition?
13. Where is the city's financial plan that addresses the revenue issues identified in the Kroll Report?
14. Has the recently opened investigation regarding SEDC been disclosed?
15. On page 7, it states that, "The audit firm of KPMG LLC has issued an unqualified opinion on the City of San Diego's financial statements." This is not true since this document is a draft and KPMG has not issued any opinion.
16. On page 7, it states that, "The independent auditor's report is located at the front of the financial section of this report." This is not true since the document is a draft and no such report exists.
17. On page 7, it states, "Our objective is to provide you with a reasonable, rather than absolute, assurance that the financial statements are free of any material misrepresentations. To this extent, the City continues to construct a comprehensive internal control framework that will achieve the objectives of the public in management of taxpayer funds." Is it a standard and generally accepted procedure to provide only a "reasonable assurance?" Were the internal controls sufficient to ensure that the statements made and the numbers used are accurate or are there specific areas where the lack of internal controls may affect the numbers and/or narrative statements?

18. On page 8, it states that, "Under the strong-mayor form of government, the Mayor is the Chief Executive Officer of the City and has direct oversight over all City functions and services except for the Personnel, City Clerk, Independent Budget Analyst and City Attorney Departments." This is not an accurate statement because the Mayor also does not have direct oversight over the City Council functions.
19. On page 8, it states that, "Under this form of government, the Mayor does not preside over Council." This statement is misleading because the Mayor does preside over closed session meetings of the council.
20. On page 8, it states that, "Under this form of government the Council retains its legislative authority; however, all council resolutions are subject to a veto of the Mayor and an enactment over veto process." This statement is misleading because not all council decisions are subject to a mayoral veto.
21. On page 10, a date should be provided to define what "current" is as it relates to the organizational structure of the city.
22. On page 12, there is no discussion about the fact that SDCERS does not have a CAFR for 2004 or 2005 or that the assumptions used in the actuarial valuation may have been affected by the Gleason settlement. This is a material fact and should be disclosed in the CAFR.
23. On page 12, it states that, "During calendar year 2004, the public voted on an amendment to the City's Charter that changed some of the retirement systems actuarial assumptions." The second bullet point under that statement discusses changing the composition of the SDCERS Board. This statement is inaccurate because a change in the SDCERS Board composition would not change any actuarial assumptions.
24. On page 26, the Government-Wide Financial Analysis discussion states that the city's net assets are approximately \$6.5 billion. Of that amount, approximately \$281 million (or 4 percent) is unrestricted and available to "finance ongoing services and obligations to the City's citizen's and creditors." Additionally, since 2002, the total amount of unrestricted assets has decreased by approximately \$352 million further reducing the city's ability to finance ongoing city services and obligations. We know that one of the reasons for the decrease in unrestricted net assets is the pension cost. Therefore, this decrease in unrestricted net assets will continue given the escalating pension debt. Because this creates a serious financial impact for the city now, and in the future it needs to be disclosed more clearly in the Management's Discussion and Analysis (MD&A). For example, does the MD&A provide an overall picture of the where are we going financially as a city?
25. On page 28, Governmental Activities, the discussion includes information about other revenues that were received due to an increase in the number of building permits issued to developers for home construction. However, I could find no discussion about the ongoing costs associated with providing city services for the residents of the new homes. This information should be disclosed.
26. On page 30, General Fund Budgetary Highlights, there is a statement regarding a \$4,436 million increase for general government and support. It states that the increase is due to

Memorandums of Understanding executed by both the Attorney's and Facilities Maintenance Departments. Is this the same as the Service Level Agreements that were found to be a problem by the Grand Jury? If so, this should be disclosed.

27. On page 31, it states that, "The City's fiscal year expenditures for the Ballpark Project were \$160,000." What was the total amount spent on the ballpark by the City of San Diego, how much of that total was from a 2002 bond issuance, how much was from a loan repayment from CCDC to the city and how much was from other funds such as the General Fund? Please provide the page number(s) showing the expenditure of \$160,000, the ballpark bond debt service and payments, and any revenue received from the ballpark.
28. On page 31, under the heading Governmental Activities, it states that, "The MSCP Implementing Agreement, Section 10(a) mandates a statutory responsibility on the part of the City to assemble the MSCP preserve. The City's fiscal year 2003 capital expenditures for this project were \$1,600." It is not clear from this statement whether or not the City is meeting that statutory requirement, whether or not the expenditure of \$1,600 was sufficient to meet the statutory requirements of Section 10(a) and what, if any, the liability could be if the City is not in compliance.
29. On page 32, Governmental Activities, it states that approved capital improvement budgets for FY 2004 includes approximately \$90 million for library projects including the San Diego Main Library. Is that accurate and how much is in the CIP budget for the Main Library?
30. On page 35, there is a limited discussion of Fiscal Year 2004. Please explain the purpose of this discussion and how it is helpful for determining material changes in the city's financial conditions from 2003 to 2004.
31. On page 69, it states that, "The City has not provided nor obtained any legally binding guarantees during the fiscal year ended June 30, 2003 to support the value of shares in the Treasurer's investment pool." What exactly does that mean?
32. On page 109, in the first paragraph, there are statements made that imply that the City of San Diego contributed its full "annually required contribution" to the pension. I believe this is a misleading statement because it does not include the Corbett, and possibly other, contingent liabilities.
33. On page 121, Fund Deficit, it states "the self-insurance fund has a net deficit of approximately (\$138,620,000) at June 30, 2003..." and "it is anticipated that individual claim settlements will be funded through future user charges subsequent to the filing of a claim and prior to its settlement." What is the self-insurance fund and why does it have a deficit? What are the user charges to which this refers? What was the 2002 self-insurance fund deficit?
34. On pages 121 and 122, there is an incomplete discussion regarding the Proposed Consent Decree.
35. On page 139, Pension Disclosure Deficiencies, it states that, "The disclosure deficiencies, ranging in importance from critical to mundane, are detailed in Appendix L to this

Report.” It appears that “this Report” refers to the Kroll Report and not the 2003 CAFR. Please clarify.

36. On page 153, there is a discussion regarding remediation on illegal acts. It states that, “The Mayor has committed the City to a comprehensive remediation plan that addresses the deficiencies identified by Kroll.” This is misleading because the Kroll Report identified the need for a financial plan, which could include additional revenues, and no such financial plan currently exists. It also states that, “The Mayor’s plan is to be implemented over the course of three years at an estimated cost of \$45 million.” This statement is misleading because some of the measures require City Charter amendments (public vote) and may not be implemented. Also, in a meeting with the Mayor’s staff, I was informed that the cost to implement these measures was estimated to be at least \$80 million, not \$45 million. Please clarify.
37. On page 155, it states that the “City has already contributed \$95 million” pursuant to the McGuigan settlement agreement. Is that the full amount contributed from the tobacco securitization revenue? In addition, it states that the City has agreed to pay \$173 million plus interest on amounts outstanding, into SDCERS, over a period of 5 years. What is the total interest payable over 5 years on “amounts outstanding” and where is that disclosed?
38. On page 162, as part of Note 22, Subsequent Events, it states that the city terminated the ticket guarantee. This information is misleading and is not helpful to anyone who is not familiar with the contract. There should be full disclosure about the financial impacts of the contract changes.
39. On page 176, the CAFR contains extra data in the form of required supplementary information. This information shows the “funded ratio has been adjusted to reflect the impact of the Corbett contingent benefit.” Are there other contingent liabilities that should be disclosed that could change the funded ratio? Is the Corbett benefit still considered a contingent benefit, even though the city must pay the benefit?
40. On October 13, 2006, I received a Certification letter signed by the CFO and City Auditor & Comptroller stating, in part, that the draft 2003 CAFR, “does not make any untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading.” What is meant by, “in light of the circumstances”? In addition, under the city manager form of government, the city manager signed the CAFR. Under the strong mayor form of government, will the Mayor sign the CAFR or delegate that responsibility?

Thank you for your attention to this matter.

Cc: City Councilmembers
City Attorney, Michael Aguirre
Independent Budget Analyst, Andrea Tevlin
City Auditor, John Torell

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